



Submission by

Alternative Technology Association

on

**AEMC's Draft Determination on the
AER's Rule Change Proposal regarding the
Economic Regulation of Network Service Providers**

5th October 2012

Submitted online at: <http://www.aemc.gov.au/About-Us/Contact-Us/Lodge-A-Submission.html?RuleChange=ERC0134>

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1.0 Introduction

The Alternative Technology Association (ATA) welcomes the opportunity to provide comment on the AEMC's Draft Determination on the AER's Rule Change proposal regarding the Economic Regulation of Network Service Providers (NSPs).

ATA is a national, not-for-profit organisation representing consumers in the energy market. The organisation currently provides service to 5,500 members nationally who are actively engaged with small, medium and large scale renewable energy projects, energy efficiency, demand side participation, electric vehicles and the national electricity market (NEM).

1.1 Overview

Efficient and effective economic regulation of NSPs, whilst of critical importance to the consumer base as a whole, is a complex area of economic policy and law and is one that ATA only has basic technical experience with.

As such, ATA, along with the members of the Small Energy Consumers Roundtable, engaged the services of a specialist consultant, Carbon & Energy Markets, to provide background information relevant to small – and mainly residential – consumers.

One area of the AEMC's draft decisions relates to effective consumer engagement – an area that ATA and many other consumer-based organisations have significant experience with and strong views on. Ours are outlined in **Section 2.0** of this submission.

The remaining areas of the AEMC's draft decision of relevance to the ATA are responded to in **Section 3.0** of this submission.

2.0 Consumer Engagement

ATA notes the draft recommendations of the AEMC with respect to consumer engagement. This is obviously an area of specific interest to consumer organisations such as the ATA.

ATA are supportive in principle of proposals that seek to enhance consumer engagement within regulatory decision making.

In ATA's view, consumer engagement typically falls into two broad categories:

- Consultation to better inform consumers of regulatory issues and decision making; or
- Empowerment of consumers to materially influence the regulatory decision making process.

ATA's reading of the AEMC's draft recommendations is that they would succeed only to achieve the former type of consumer engagement - informing consumers of issues and decision making from the regulator or network business perspective, yet will fail to empower consumers to contribute or influence the regulatory process.

2.1 Empowerment versus Consultation

Simply stating 'how' a network business has consulted with consumers; and the preparation of Issues Papers from the regulator's perspective, will in ATA's view, do little to enhance the ability of consumers to materially influence outcomes in the energy market.

Where consumer demand and choice is influencing regulation and business practice, Issues Papers and similar such consultative tools (e.g. benchmarking reports) would be developed by consumers in the first instance – for consultation and discussion with service providers, and overseen by a market regulator that is in the main attempting to prevent market failure and act as an independent arbiter where unresolvable conflicts arise.

Whilst a better informed consumer sector is worthy of pursuit, the more important goal should be to create the conditions whereby consumers are actually influencing efficient and fair outcomes – and whereby the key issues from a consumer perspective are being identified upfront, and consumers have an equal state in their resolution.

To take one issue as an example of how consumers might drive regulatory change – if residential small consumers developed an Issues Paper on the Value of Customer Reliability and other reliability metrics such as SAIDI and SAIFI to them, would they arrive at the same significantly high value that is currently contributing to the over-investment in distribution and transmission networks to meet peak demand?

This issue is worthy of consideration from the consumer perspective but is not one that is likely to be raised voluntarily by network businesses during a consultation session or included voluntarily within an Issues Paper developed by the AER.

2.2 The Need for a Stronger Consumer Sector

Relatively high spending power, regulated electricity prices, geographic monopolies, lack of consumer choice and the relatively secure and reliable supply of electricity to the majority of Australians has meant that historically, consumers have not had a high degree of engagement with the energy market.

Consumer choice hasn't naturally driven outcomes in the market in the same way that they have in the telecommunications market for example.

This was part of the rationale for the establishment of the Consumer Advocacy Panel – a body designed to resource consumer advocacy and so bring about consumer interest and engagement in the energy market.

It is clear that we are entering a new phase with regards to the evolution of the energy market, particularly from the consumer perspective.

Electricity and gas prices are rising and the traditional supply chain model of providing energy services is causing increasing inefficiencies in the market, at the unnecessary expense of consumers.

At the same time, technological developments and alternative end use solutions are developing at a rapid pace, leading to increased levels of consumer interest in the market. By way of example, the cost of grid connected solar power has now dropped to below parity with the price of retail energy, and more than one million Australian homes now have solar systems.

The complexity of the energy market however remains a fundamental barrier to the engagement by individual consumers and even many specialist consumer-based organisations, and is stifling their ability to influence outcomes, particularly at the level of energy networks.

Going forward, a dedicated and stronger consumer sector, representing the interests of the diverse range of consumers that exists in the Australian energy market, will be necessary.

2.3 The Power Imbalance in Energy Markets

There remains however an enormous imbalance between the advocacy capacity, and therefore power, in the market between generators, network businesses and retailers as compared with consumer advocates.

One only has to consider the regulatory reset processes that have occurred in a number of jurisdictions over the past decade to understand the magnitude of this power imbalance.

This week, Victorians learnt that their energy bills over the next three years would increase approximately 3% as the result of Victorian DNSPs being awarded an additional \$255 million over 2013 – 15 after their legal challenge to the AER's regulatory decision for the current reset period¹.

Despite their attempts, a number of consumer advocate organisations were unable to even engage in this legal process, let alone influence the outcome.

¹ <http://www.theage.com.au/victoria/bills-to-climb-by-255m-20121002-26xe0.html>

In a properly functioning market, consumers would have been comprehensively engaged in this legal challenge at every step of the process, advising both regulators and judicial decision makers what they require from network businesses with respect to market outcomes.

The ability of the consumer sector however to engage the necessary legal and technical capacity to represent the consumer interest in these significant regulatory processes is minuscule, in comparison with our network, retail and generation business counterparts.

From the small consumer perspective (i.e. residential and commercial consumers consuming less than 160 or 100 megawatt hours per annum), the majority resource their advocacy and research capabilities from one source of funding – the Consumer Advocacy Panel. The Panel’s funding comes from consumer bills – i.e. consumers funding consumer advocacy.

The Consumer Advocacy Panel states that it manages a total budget comprising just over \$2.2 million for consumer advocacy and research².

This ‘pool’ of funding was shared between 11 different business advocacy organisations and 27 different residential advocacy organisations – an average of \$58,000 worth of funding per organisation, equivalent to approximately a 0.4 – 0.6 full time equivalent staff per organisation.

With 8 million small customers within the National Energy Market, the \$2.2 million of funding is equivalent to a contribution toward consumer advocacy of \$0.28 per annum per customer. ATA’s view is that small consumers would very likely be willing to pay far more than this amount to drive better market outcomes for consumers through consumer advocacy

A doubling of this amount would clearly add no noticeable amount to consumer bills, but would have far greater benefits in terms of placing downward pressure on bills through more effective advocacy

ATA understands that the Panel’s budget has not increased in real terms, yet at the same time the lobbying power of the industry stakeholders with which consumer advocates must contend has grown measurably.

2.4 The Need for Increased Resourcing

This current level of resourcing simply cannot meet the current and increasing demands of the energy market on consumer representatives with respect to the number and technical complexity of policy reviews and regulatory processes.

The complete imbalance between the level of resourcing of consumers, as distinct from market businesses, is also glaringly obvious in this regard.

The irony of this situation is that consumers actually pay for the advocacy capacity of network businesses, retailers and generators through consumer bills. Effectively, ATA estimate, consumers pay at least one hundred times more for the legal and technical capacity of advocates and peak bodies of the energy networks and market participants than they do for their own consumer advocate representatives³.

² According to the latest publicly available CAP Annual Report, that of 2010/11,

³ Based on the current Consumer Advocacy Panel budget of \$2.2M.

This is a grossly inequitable situation and one that must be addressed if governments and regulators are genuinely seeking balanced policy debates and market outcomes into the future.

ATA notes that such a transformation in the role and resourcing of the consumer sector in the energy market cannot be achieved by the AEMC alone and is heavily reliant on policy makers and governments to understand the magnitude of the problem as well as attempt to address it.

In this regard, ATA press upon the AEMC to raise these energy market power imbalance issues with SCER and with other regulatory and related bodies where possible, and seek to drive the necessary changes to bring about a more balanced energy market debate that improves the long term outcomes for all consumers.

3.0 Response to Other Draft Determination Decisions

3.1 Rate of Return Framework

ATA understands that the AER has had complete discretion to determine the rate of return for gas NSPs, and until the revised arrangements for Chapter 6 took effect, it had similar discretion in the determination of the allowed returns for transmission NSPs.

Since the revised Chapter 6 6A took effect, ATA understands that the AER has had less discretion in electricity, but still a substantial level – other than in the determination of the risk free rate and debt risk premium.

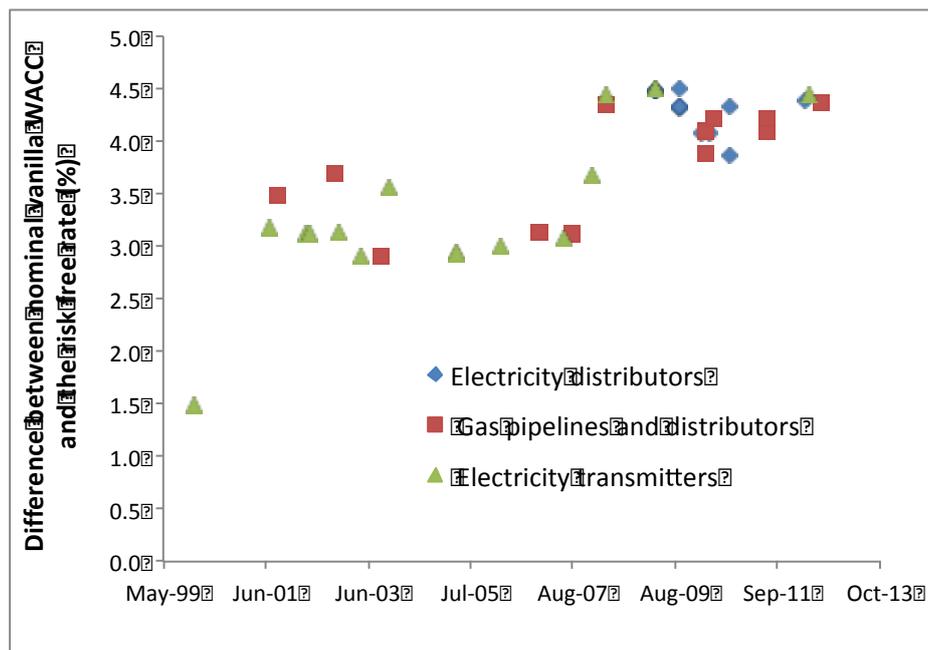
To inform an assessment of what the greater freedom for the AER in this area might deliver, the consultant for the Small Consumers Roundtable compared outcomes in the AER’s regulation of gas pipelines, and also of transmission NSPs until the revised Chapter 6 took effect, with the outcomes that have been delivered since the implementation of Chapter 6 and 6A.

This covered 40 regulatory determinations that the ACCC and then the AER made since 2000, for ‘covered’ gas pipelines, gas NSPs, electricity transmission NSPs and electricity distribution NSPs.

The analysis is of the difference between the nominal vanilla weighted average cost of capital (WACC) less the Risk Free Rate. Some of these WACC decisions were varied on appeal to the “Australian Competition Tribunal (ACT). The consultant used the AER and ACCC’s decisions as opposed to the ACT’s varied values, as the focus is to understand the AER’s decisions – not the ACT’s.

The results of this analysis are presented in **Figure 1** below.

Figure 1: Difference between Nominal Vanilla WACC and Risk Free Rate in all NSP Decisions by AER & ACCC



Source: AER and ACCC Regulatory Decisions

The following conclusions can be drawn from the analysis:

- The ACCC determined comparable WACC for gas pipelines and distributors and electricity transmission NSPs.
- The AER has determined comparable WACC for gas pipelines and distributors and electricity transmission and distribution NSPs.
- The step up in the determination of the WACC since 2008 corresponds to the implementation of the arrangements in Chapter 6 and Chapter 6A of the Rules. But there were no changes in the determination of the WACC for gas NSPs and yet the AER has determined a WACC for gas NSPs that is comparable to that for the electricity NSPs.

The analysis supports the conclusion that the AER's concern that it has not had sufficient discretion in the determination of the WACC of electricity NSPs is hard to sustain.

On the basis of this assessment, it could be concluded that greater discretion for the AER in the determination of the allowed return, though generally desirable, has not influenced WACC determinations in the past and so may not do so in future.

3.2 Determination of Opex & Capex Allowances

ATA agrees with the AEMC that Clause 6.12.3(f) serves no useful purpose. The AER should be able to determine an efficient expenditure allowance subject to general requirements, and there appears no reason why it should be constrained to make adjustments based only on NSPs' proposals.

ATA also supports the excision of the requirement that the AER must have regard to the 'circumstances of the relevant NSP' in its benchmarking. Excising this requirement will avoid wasteful argument and may embolden the AER in developing and using benchmarks.

3.3 Regulatory Processes

ATA supports the AEMC's direction to extend the regulatory decision making process by six months and hope that this may address concerns about the abuse of regulatory processes by NSPs and of their claims to confidential information.

However, we do note the AEMC's use of the term 'incremental' and suggest that these will in no way circumvent the significant power imbalance that exists between network businesses and consumers in regulatory decision making. We refer to our comments in **Section 2.0** of this submission in this regard.

4.0 Further Contact

Thank you for the opportunity to provide further comment to this process and please do not hesitate to contact us at Damien.Moyse@ata.org.au or on (03) 9631 5417.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Moyse', with a large, stylized flourish extending from the bottom of the 'y'.

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